

Internal Revenue Service

memorandum

CC:TL:TS/WHEARD

TL-N-9556-88

date: DEC 23 1988

to: District Counsel, Louisville
Attn: Jill Warner

C:LOU

from: Assistant Chief Counsel (Tax Litigation)

CC:TL

subject: Rule 248 Decision Document for Straddle in TEFRA and Non-TEFRA Years

This is in response to your request for technical advice dated September 22, 1988.

ISSUE

How should a decision document under Tax Court Rule 248 reflect an integrated settlement with respect to a straddle investment covering both TEFRA and non-TEFRA years?

CONCLUSION

We suggest that the decision document simply require all partners to treat the gain leg of their straddle in the TEFRA year consistently with their loss leg. See sample attached. Thus, the decision would require the removal of the phantom gain for those taxpayers who concede the offsetting straddle loss in the loss leg years. The decision document would retain the gain with respect to partners whose loss leg years are barred or who claim and refuse to concede the offsetting straddle loss.

FACTS

In a number of similar cases, a petitioning partner, either a tax matters partner or a notice partner, wants to accept the outstanding settlement offer in a TEFRA partnership case involving a government securities tax shelter promotion which affects three taxable years of each partner. Usually, in such cases, the first two years of the promotion are not TEFRA. The settlement disallows deductions in the first two years and removes the phantom gain in the TEFRA year. Many of the other partners have not accepted the settlement and are not expected to do so in the near future. For a few partners the statute of limitations has expired for the non-TEFRA years.

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District Counsel is concerned that if the decision document only reflects removal of phantom gain, some partners will obtain a tax benefit for the TEFRA year without agreeing to a deficiency in the loss years of the straddle.

DISCUSSION

Tax Court Rule 248 provides for the manner of submitting a decision document to the Tax Court when a basis for settlement has been reached with respect to a petitioned TEFRA year. The Rule requires that either a stipulated decision (Rule 248(a)) or a proposed form of decision (Rule 248(b)) be submitted to the Court. Although not specifically mandated by Rule 248, the implication of this rule is that the decision document should normally reflect the applicable terms of the settlement.

A problem has arisen in the instant case since the settlement necessarily covers both the TEFRA year before the Court as well as the prior non-TEFRA year. Deductions are disallowed for the loss leg of the straddle and phantom gain is removed in the gain year. Since the Court only has jurisdiction over the gain year, ^{1/} the decision document reflecting the settlement should, arguably, only reflect the reduction of income in the gain year of the straddle.

The problem is that other partners in the partnership, who are still contesting the disallowance of deductions in the prior non-TEFRA years, can, arguably, by invoking the consistent treatment provisions of section 6224(c), have their gain reduced without having to concede the corresponding loss. If the non-agreeing partners prevail (or their prior years have closed), they will receive a double benefit.

TEFRA provides for uniform treatment (through litigation or settlement) of partnership items among partners for each partnership taxable year. See I.R.C. §§ 6221, 6226, and 6224(c)(2). A straddle, however, is a scheme to abuse the tax system encompassing a strategy which necessarily must cover more

^{1/} Section 6226(f) provides:

(f) Scope of Judicial Review.--A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all the partnership items of the partnership for the partnership taxable year to which the notice of final partnership ~~is filed~~ ^{is filed} and the ~~items~~ ^{items} among the

than one year. Typically, ordinary loss is generated in the early year or years and an approximately equal offsetting capital gain is generated in the later year. Typically no risk or profit motive is involved. Since a straddle is necessarily a multi-year integrated scheme, settlement or litigation with respect to the scheme must necessarily cover all the years of the straddle. In the present case, however, the loss years are non-TEFRA and the unified litigation procedures of TEFRA only apply to the gain year, arguably preventing a comprehensive and consistent disposition of the straddle. Thus, a tension exists as to how a decision document subject to TEFRA may extend to an integrated tax scheme covering both TEFRA and non-TEFRA years.

Both the objective of TEFRA and the purpose of the settlement would be better served by a decision document requiring that each partner treat his gain leg according to how he treats the loss leg of the straddle scheme. Recognizing the integrated multi-year effect of the scheme, the Court could require that each partner complete the second half of the transaction according to how he completed the first half of the transaction.

The Court will have jurisdiction to enter a decision requiring consistent treatment of the gain leg with the loss leg if it finds that our proposed form of decision reflects the proper "allocation" of a "partnership item". I.R.C. § 6226(f). Treas. Reg. § 301.6231(a)(3)-1(b) provides that the term "partnership item" includes "legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc.," flowing from a partnership. 2/ A "legal determination" which is a "partnership item" is that partners must complete the second half of their straddle transactions in conformity with the first half. The "allocation" of this partnership item is reflected by the required consistent treatment of the gain leg with the loss leg on a partner by partner basis.

2/ Section 6231(a)(3) provides:

(3) Partnership item.-The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner

In summary, since the Court has jurisdiction to make a determination with respect to a partnership item and its allocation, and the requirement of consistent treatment of the straddle legs is both a determination and allocation of a partnership item, the Court may enter a decision solely with respect to required consistent treatment of the gain leg of the straddle.^{3/}

An argument against such a decision document is that the mandate of TEFRA, that "partnership items" must be determined at the partnership level, implies that the Court must make only a single determination with respect to the amount of a partnership item (i.e., the gain or loss thereof) which is binding on all partners. See I.R.C. § 6226(f) (Court has jurisdiction "to determine partnership items . . . and the proper allocation"); Treas. Reg. § 301.6231(a)(3)-1 ("partnership items" are items of deduction, income, credit, etc., of the partnership); but see, Treas. Reg. § 301.6231(a)(3)-1(b), supra ("partnership item" includes underlying legal determination).

If the Court does not accept our proposed form of decision document, please contact us. We are currently in the process of discussing possible procedures with the Court which might be adaptable to the instant situation.

We also request that you forward your motions and decision documents relating to this matter to this office for review before filing with the Court.

^{3/} Once a decision is entered it will be final with respect to all partners. A partner will have 2 years after a decision is entered to file a claim for refund based on the misapplication of the decision document to them. I.R.C. § 6230(c)(2). Once a claim is filed under section 6230(c), the partner will have 90 days to file suit as provided under section 6532. See also I.R.C. § 6230(d)(3).

- 5 -

Please refer any questions you have regarding this matter to
Bill Heard at FTS 566-3289.

MARLENE GROSS

By: Kathleen E. Wheatley
KATHLEEN E. WHEATLEY,
Chief, Tax Shelter Branch

Attachment:
As stated.

DECISION

Pursuant to Rule 248(b) it is:

ORDERED and DECIDED that the following statement shows the adjustments to the partnership items of ABC partnership for the taxable year 1983.

<u>Partnership Item</u>	<u>As Reported</u>
Gain on Securities straddle	\$100,000.00

As Determined

For partners who have conceded
offsetting straddle
loss for taxable years
1981 and 1982

For partners claiming
and not conceding
offsetting straddle loss
for taxable years 1981
1982

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\$100,000.00

Judge